RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Oct. 13, 1993 **LETTER 1132**

THE MARKET: Ah, October, the "dangerous month" is here. And let's face it, stocks have had ample opportunity to fall apart. We have that flagrant non-confirmation in the D-J Transportation Average (i.e., the Transports have never bettered their April high of **1683.08,** as you can see on the chart below). We've had a churning market with a steady but very unimpressive rise in breadth. We've seen many important stocks sustain major losses. But still the stock market holds together.

The Buying Stampede, which began almost a year ago (it started last October), is still intact. That means that for one incredible year the advance-decline ratio has been advancing without ever having suffered so much as a one point decline. Let me put it another way -- any one point decline (from its most recent high) in the A-D ratio would have ended the Buying Stampede. So far it hasn't happened.

What, no one point decline in the A-D ratio in the last 12 months? Amazing. I can tell you that I've never seen anything like it. I've seen much more powerful and exciting Buying Stampedes, but NEVER a Stampede that lasted a full year (for the benefit of new subscribers, a Buying Stampede is any rise of five points or more in the A-D ratio without an intervening correction of one full point).

How to explain it? I explain it as follows: (1) 38% of all the stocks on the NYSE are now interest-rate sensitive, and low rates drive stocks up; and (2) the Fed has driven rates down to extreme lows. The irony is that with the US savings rate this low (around 4%), and with massive deficits, US interest rates should be considerably higher than they are today. But the Fed has embarked on a course of reliquefying the banks and reflating the economy. As far as the dollar is concerned, just let it sink. The lower the dollar, the more attractive the situation for US exports.

Of course, there's a third possibility. And that is that the world's stock markets are reflecting a coming world reflation or even a boom. There are now 27 million unemployed in Europe, and high unemployment in the US. But that hasn't affected global stock markets. The stock markets of almost every nation in Europe are now surging, and in fact, most are far outperforming the US market.

Last week we saw the gold stocks turn strong (without, however, a corresponding rise in gold). But you have to wonder if the across-the-board rise in the gold shares aren't telling us that we've seen the low for deflation, and that inflation is now in the wind.

If inflation is "just around the corner," we should receive hints of it from both the bonds and the utilities. Note on the page 1 chart that the Utility Average is starting to slide. Furthermore, the bonds looks as if they have recorded a double top. Admittedly, that's an early diagnosis, and I do want to see more.

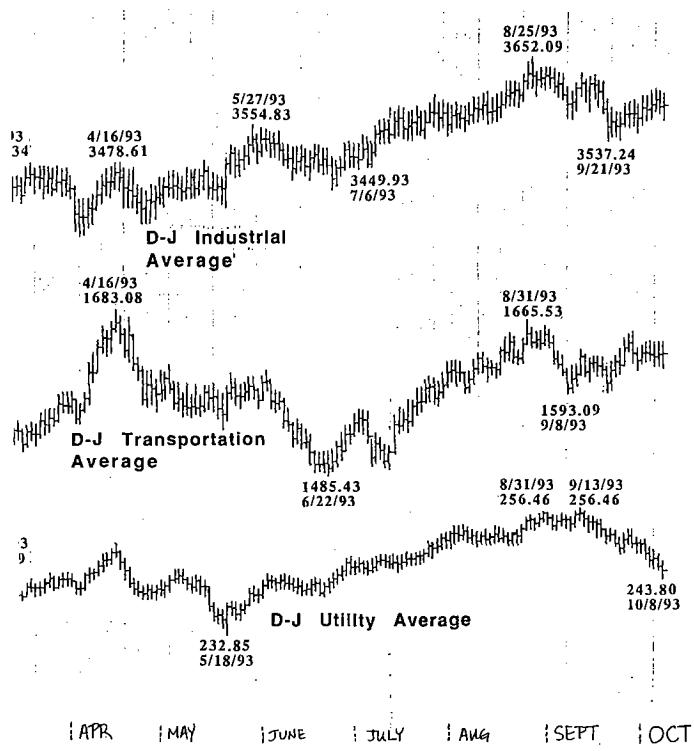
THE PICTURE: The massive build-up of America's M-1 money supply continues. But something new is added -- we're beginning to see expansion in the broader money supply areas: M-2 and M-3. The great money supply balloon, puffed up by a frantic Fed, continues to inflate. (Ironically, with the Fed's new emphasis on interest rates, no one seems to be noticing the money supply figures, and the Fed appears to be completely ignoring the surging money supply statistics.)

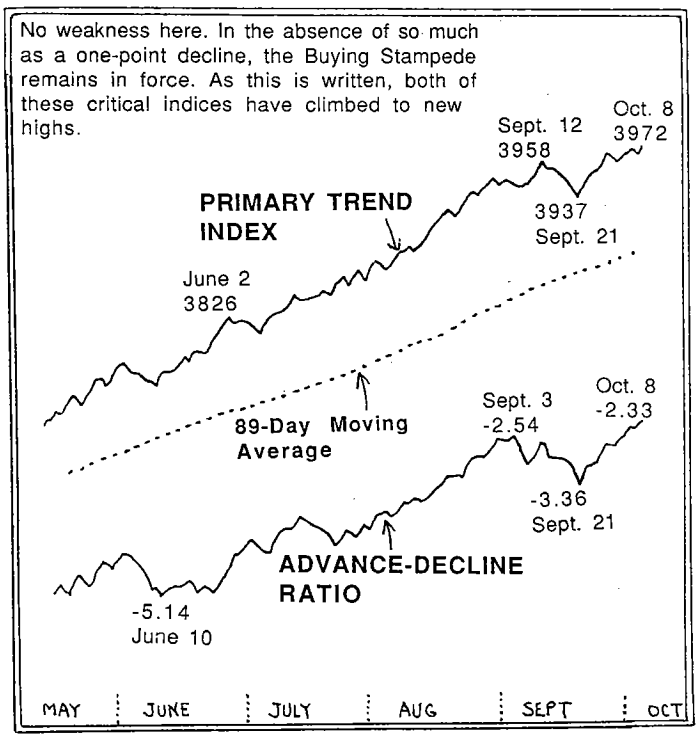
Oct. 1 DJIA 3581.11; PTI 3964; A-D Ratio -2.53
Oct. 8 DJIA 3584.74; PTI 3972; A-D Ratio -2.33
Dow Yield: 2.84%; Dow Price/Earnings: 43.3
Dow 200-day MA: 3468; Dow 30-day MA: 3600
Dow Times Book Value: 3.12; PTI 89-day MA: 3909
Percentage of Undervalued Blue-chips: 8%
Low Risk Buy Index: +73

Most of this ocean of money (so far) has been funneling directly into the US financial markets -- stocks, bonds, mutual funds. The statistics on the funds are mind-boggling. Americans, starved for income, are obviously using stock and bond funds as a proxy for savings. In the latest month for which we have statistics, August, buyers bought a record $24.8 billion of funds -- $12.8 billion in equity funds and the rest in bond funds. For the first eight months of '93 a mind-blowing $81.9 billion of new money flowed into equity funds.

But wait, something else is going on. Mutual funds are now sending billions of dollars into foreign markets. Funds that invest solely or primarily in foreign stocks took in $5.4 billion in August, up 74% from a year ago. Other mutual funds are also moving into the area of foreign stocks and bonds.

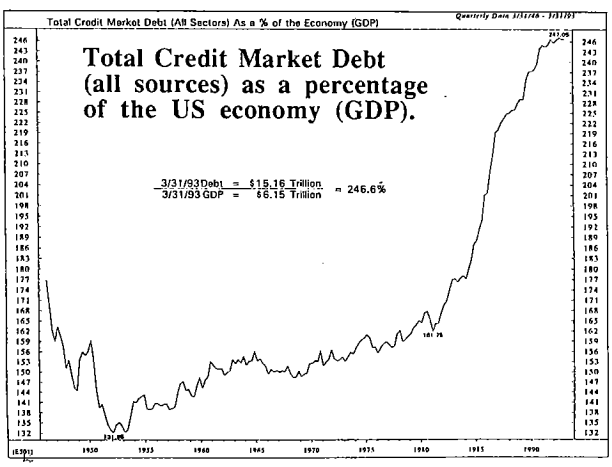
When billions of US dollars move into small and often illiquid foreign markets, the result is a mighty "swoosh," as the world's stock markets head skyward. US monetary inflation is being exported in the form of billions of dollars heading overseas, looking for "foreign bargains." What's happening is that we're creating a global balloon, a balloon that's slowly but surely lifting towards the heavens.





It's obvious (at least to me) that the Fed (and probably all central banks except those of China and Germany) are in the process of reflating. In reality, these banks are simply fighting the deflationary forces of debt. In literally all the nations of the world the ratio of debt to Gross Domestic Product (GDP) is sky-high. The debt phenomenon has acted as a giant descending roof, pressing down on the world's economies. And the central banks are fighting it tooth and nail.

The accompanying chart (thank you Ned Davis) shows the US' ratio of total credit market debt to GDP. This is the debt-monster that is bearing down on the US economy, even as the Fed fights the trend by loading the banks with additional reserves.


Total Credit Market Debt (All Sectors) As a % of the Economy (GDP)
Total Credit Market Debt
(all sources) as a percentage
of the US economy (GDP).
3/31/93 Debt = $15.16 Trillion
3/31/93 GDP = $6.15 Trillion = 246.6%

All veteran readers of these Letters know my "inflate or die" thesis. Well at present these two forces are in equilibrium -- with the inflationary forces of the Fed battling the deflationary forces of debt.

How powerful are the deflationary forces? Think of an economy where the central bank (the Fed) is feeding reserves into the banks at double digit rates and the economy is not roaring. Imagine an economy that is being stimulated by federal deficit spending of $1 billion a day, and that economy is not booming. Imagine an economy where savings are below 4% (which means, of course, that the public is spending literally every dollar they earn) and that economy still isn't surging. That's a picture of the US economy today. We're at the fulcrum, the balance point between massive inflation and massive deflation.

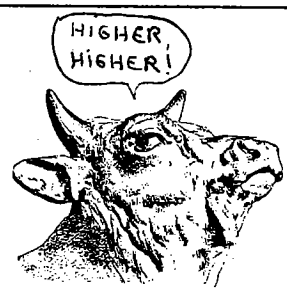
Which will be the winner, pressing debt or the rising money supply? Brilliant men and women have made excellent cases for either side of the equation. My opinion -- somewhere ahead we're going to see a run on the dollar plus all the trouble any bear could want. But first, and this is a good possibility, we could get the long-awaited "blow-off." We could see the final surge as the economies of the world pick up and the stock markets of the world run wild. I put the odds of this occurring at, well, I guess around 50/50.

The one sure-thing I see ahead is a continuing slide in the purchasing power of the dollar. With the US national debt pushing towards $5 trillion, the long term outlook for the dollar has to be bleak. You cannot pay off that kind of debt with anything but paper dollars, dollars that are steadily declining in purchasing power and value.

Given the picture that I foresee, the government will want more and more of the savings, the estates and the earnings of the American people. At the same time, ironically, the great majority of Americans will demand that their government provide them with more of the good life. Unfortunately, the government will not be able to deliver. And this will fan the river of discontent that is now running through this nation.

I firmly believe that the crime, the corruption, and the civil disorder that is enveloping the US is basically a result of the 50 years of inflation that have followed World War II. Destroying a people's savings, confiscating the fruits of their labor, has an unbelievably corrupting effect on the whole society. This nation has been living over its head literally since WWII. And we've been paying for the party with the greatest and subtlest tax of all -- inflation. So here's another one of my predictions -- the greatest push by our government to tax and inflate still lies ahead.

INVESTMENT POSITION: El Toro remains in the box. Last week my PTI broke to another in a seemingly endless series of new highs. The advance-decline ratio came down to within 0.13 points of ending the buying stampede, but then it turned up and rallied to another new high. Prognosis: the bull stays in the box.



As you know, we keep a slew of group charts on the Low Risk Index, and here are the latest changes. The following groups have all turned up from below zero, meaning that they have given low risk area "buy signals." For the benefit of new subscribers, I should say that buying on the low risk signals represents the most advantageous time to buy the stocks in these given groups. The signal groups are Money Center Banks, Oils (integrated majors), Publishing, Railroads, Pharmaceuticals, Waste Management.

What to do, what to do? The public has the bit in its teeth. They are rushing willy-nilly into the mutual funds at the rate of almost a billion dollars a day. You can elect to join them, or you can elect to watch the show from the sidelines. My personal choice -- watch 'em. There's a decent chance that the stock market is entering a "blow off" stage, a parabolic rise towards the vertical. These move are always the most exciting and the most dangerous. I'll watch the action with fascination, but I need my sleep.

EXHAUSTION: One of the theories (I guess it's my own) that has been brewing in my mind for years is this idea of exhaustion. I look at the massive crime wave that is literally taking over the streets of America, I look at the widespread starvation in Africa, I look at the unending war in Yugoslavia, I look at the parabolic rise in the global population, I look at the interminable spread of government in the US, I look at the rising debt in the US, I look at the multiplying cases of AIDS worldwide, and I wonder -- what

can possibly bring these trends to an end? Or worse, will they ever end?

In every instance only one answer comes to mind. The answer is that all these trends very definitely will end. How will they end? They'll end only in exhaustion.

Exhaustion is the way the Black Death (which wiped out one-third of Europe's population) ended. Exhaustion is the way the Spanish, the Dutch and the British Empires ended. Exhaustion is the way that Hitler's Third Reich ended. Exhaustion is the way that nuclear proliferation ended (if indeed, it has ended). Exhaustion is the way that the infamous witch hunts of New England ended. Exhaustion (economic) is the way communism is ending (only Cuba and N. Korea remain).

I guess another way of putting it is that every trend (of any kind) contains the seeds of its own destruction.

I ask myself, does a great concept like democracy possess the seeds of its own destruction? And even here, the answer seems to be, yes. The seeds of democracy's destruction are born and are growing in the idea that one group (the underprivileged, the poor, the uneducated, the lazy) can vote themselves the fruits of another more productive group's labor. A second seed in the demise of democracy (and capitalism, by the way) is the concept that a democratic society must be responsible for the happiness and comfort of all its citizens. A third seed is the concept (or I should call it a wish) that a nation can spend more than it produces, year after year, and escape without pain and without damage.

At any rate, I think you see my point. Now, to translate all this to the area of investments (which, I assume, is what you pay me for), let me talk a bit about the stock market.

I note that currently there is a huge debate regarding "when the bull market will end." Conservative investors point to overvaluation as a sure sign that the end is near. Bullish investors, fund managers, brokerage houses, many gurus, state that the stock market may indeed be dearly priced, but compared with today's low interest rates, compared with the new expanding world markets, and combined with our "new and more sophisticated" knowledge of how markets work, the end of this bull market must be placed far off into the future, maybe as many as three to five years away. Some "experts" are even claiming that with the help of the Fed, bear markets (certainly severe bear markets) are a thing of the past.

So we have the bears sitting on the edge of their chairs waiting for the end. And we have the bulls, perhaps mildly worried, but basically cheerful. We have thousands of fund managers doing their best to keep up with the averages, or hopefully, beating the market with other people's money. And we have dozens, even hundreds of predictions on the part of various economists and experts as to when, if ever, this great bull market will end.

Do I have an answer to that trillion dollar question -- when will the bull market end? Yep, my answer is that this bull market will end when the great majority of stock buyers are thoroughly EXHAUSTED. Actually, it's absurd to try to pin-point exactly what day or what month the bull market will reach the exhaustion point. I don't think it can be done. But somewhere ahead the stock market will arrive at that delicate point, that magical and unpredictable day -- when the buyers have passed their peak of strength. That will be the fateful day when the bull market dies of exhaustion.

There's an old market adage that states, "It takes buying to move a market up, but stocks will fall of their own weight." Believe it, it's true. That being the case, once this bull market reaches its ultimate exhaustion point, once the buying power of the bulls is spent, the market will topple over and fall of its own weight, and a primary bear market will begin.

So again I say, don't ask me to pin-point the day or the month of the final top. I can't do it. Nobody can do it. I can tell you how it will happen, but I can't tell you when it can happen. And all our valuation studies can only tell us whether we're on safe land or thin ice from a historical standpoint. Let's not mince words, from a historical standpoint this market is on very thin ice. But the buyers are still coming in. The new issue market is still hot. Everybody and anybody who ever wanted to go public with their company is coming out with a new stock issue. On September 29 Barnes & Noble (a book seller) came out with an offering of 8.2 million shares at 20. Eager buyers bid the stock up to 29 3/4 on the same day. That should tell us something. On the mutual fund front, money is coming into the funds at the rate of over $20 billion a month.

Exhaustion? It's obvious as this is written that we're not there yet. No, I can't pin-point that infamous day (somewhere ahead) when the greatest bull market in history dies, and the big bear takes over. What I do hope to do is IDENTIFY the turn in the tide.

Are there signs of exhaustion yet? Yes, there are a few. One sign (or hint) that is apparent is the "churning effect" in the stock market as day after day advances and declines on the NYSE tend to be rather evenly matched. This suggests that sellers are moving in to give the buyers what they want, a hint that the bull is getting tired. Another hint -- many important stocks, big stocks, have topped out, and I don't have to name them, you know them as well as I do. A third more fundamental hint -- interest rates are extremely low. The Fed is almost afraid to take them lower. But any rise in rates from here would put pressure on the stock market. In other words, interest rates are approaching the exhaustion phase on the downside.

In the meantime, relax, take it easy, don't be impatient, take all the predictions (bullish and bearish) with a grain of salt. The market will do what it has to -- in its own good time. The hour of the bull's exhaustion is not here yet -- but as surely as night follows day that hour of exhaustion does lie somewhere ahead.

A FAVOR: About 7,000 people subscribe to these Letters, and I figure each Letter is read by 3 or 4 people (maybe considerably more since a lot of individuals and brokerage houses copy the Letters, something I can't control). That means at least 25,000 people read the Letters. Now a favor -- a number of you must have gone through EDTA Chelation. If you have, would you please send me your experiences with it. Many, many thanks.

NOTES & QUOTES: I'll admit it, I was shocked by this first paragraph in the September 25 "American Survey" section of the rather liberal British *Economist* magazine. Here it is: *"Not since Franklin Roosevelt's War Production Board has it been suggested that so large a part of the American economy should suddenly be brought under government control. Nor, ever, has a usurping president so soothingly reassured a nation as did Bill Clinton in his address before Congress on September 22nd. Armed with his plans for reforming health care and waving his 'health security card,' Mr. Clinton proposed nothing less than that government should seize the levers of an industry that accounts for one-seventh of the American economy."* Russell comment: Whew, quite a paragraph for the rather liberal *Economist.*

* *

It's ironic, while the US moves towards more and more government ownership and bureaucracy, Europe (which has been very socialistic) goes the other way. France is on a program of massive "privatization" of government run businesses. Germany (see clip) is cutting social programs as are many other nations of Europe. The Clinton's are sending the wrong message to Americans, but it figures, since the Clintons are still living in the '60s.

Germany plans cuts in social programs

NEW YORK TIMES NEWS SERVICE

BONN, Germany — Struggling to cope with the huge costs of rebuilding formerly Communist east- Klaus Kinkel, Germany's foreign minister and deputy chancellor, headed the Cabinet meeting that approved the cuts because Kohl is

* *

Speaking of messages, here are a few that you can try to decipher. The first (from the Sept. 30 *LA Times)* shows that the public still wants more government (even if they don't understand the implications).

THE TIMES POLL

By 2-1 Margin, Public Backs Health Care Plan

By RONALD BROWNSTEIN
TIMES POLITICAL WRITER

WASHINGTON—With his all-points sales pitch, President Clinton has won broad initial support from the public for his sweeping health care plan, a Times Poll has found.

tal change to the way government is run."

The Times Poll, supervised by John Brennan, surveyed 1,491 adults from Sept. 25 to 28. It has a margin of error of plus or minus three percentage points.

At the most basic level, Ameri-

But there's a little problem. Suppose they gave a national health program party and no doctors showed up? (Clip from the Sept. 30 *NY Times.)*

Doctors Rebel Over Health Plan In Major Challenge to President

A.M.A. Says Its Move Reflects Patients' Interests

By ROBERT PEAR
Special to The New York Times

WASHINGTON, Sept. 29 — The American Medical Association urged doctors today to lobby patients to oppose central elements of President

an unprecedented national network of physicians" to persuade Congress to make substantial changes in Mr. Clinton's proposal. Hundreds of doctors,

* *

Sometimes items and events that no one seems to notice become issues of major importance. This one (*USA Today,* Sept. 24) caught my eye.

PROBING THE FED: Federal Reserve Chairman Alan Greenspan will be among those called to testify next month at four hearings questioning the Fed's accountability and the constitutionality of its policymaking powers, House Banking Committee Chairman Henry Gonzalez, D-Texas, says. The sessions are scheduled for Oct. 7, 13, 19 and 27.

There's no question in my mind that the Federal Reserve System's license to create money is unconstitutional. The Constitution is explicit about who can create money (Congress), and it is also explicit in saying that a dollar is not just paper but is defined in terms of gold and silver. My opinion: since the Federal Reserve System creates money (bank deposits) at will (which is against the explicit direction of the Constitution), I would say that its "policy-making powers" are also unconstitutional. It will be interesting to see if anything comes of the Banking Committee's October probes (I'm sure that Chairman Gonzalez is well aware of what the US Constitution says about who is legally entitled to create money and also about the very constitutionality of the Fed itself).

* *

Some predict a world boom and others predict a world bust. Two weeks ago IMF Managing Director Camdessus warned of the risk of "devastating trends" hitting the world economy, and he appealed for a global strategy to combat them. Camdessus painted a bleak picture of a world beset by high and rising unemployment, anemic growth and mounting protectionism. "There are important problems," he told the IMF, and "Indeed, several of them could become devastating trends if they are not reversed." The IMF has forecast that industrial countries will experience growth of only 1.1% this year and 2.2% next year.

* *

The size and scope of derivative products (futures, options, puts, calls, etc.) is simply staggering. Bill Gary writes *Price Perceptions* (CIS, Inc). out of Oklahoma City and he offers this amazing statement: "The volume of trade in physical commodities on the Chicago Mercantile Exchange currently represents only two percent of the total. The remaining ninety-eight percent is paper assets such as currencies, T-bills and stock indexes. We have become an information society -- a society that places more value on intangible and intellectual assets than physical assets." Russell comment: Incredible: on the CME only two percent of the total volume is real physical assets -- the rest is really speculative paper and positions.

The derivative market is huge. It's an $8 trillion market, and US banks are heavily involved in it. The derivative market is so huge, in fact, that its power really overwhelms the central banks of the world. When a given currency (backed by derivatives) starts to move, the central banks are almost helpless to stop the movement. Of course, this kind of free market action makes governments and politicians nervous. Result: government wants to get into the act, take control. In fact, last week Eugene Ludwig, Comptroller of Currency, called for the creation of a task force to oversee US banks' involvement in the derivatives market. So who knows, we're probably watching the birth of a new government bureaucracy.

* *

This from Mark Melcher of Prudential Securities: "I think Washington is more corrupt, more dissipated, more wasteful, and more cynical than ever. And not because of Clinton. It is a function of size. As governments grow, they become proportionally more corrupt, wasteful, and unresponsive . . . Virtually no sector of the US economy is totally unaffected by Washington. Washington will disburse almost $1.5 trillion this fiscal year, close to one fourth of GDP." Russell comment: The US government has taken on too many functions. There are now so many agencies, divisions, duties and functions that nobody knows what it's all about anymore. If I were President I would draw up a massive list of all the functions and start eliminating. The US government today is an absolute miasma of functions. If the men who drew up the Constitution were alive today, they absolutely would not recognize the US government.

* *

According to London's *Financial Times*, a majority of French, 54%, would now vote against the Maastricht treaty, according to an opinion poll published Sept. 20. To me, this means that the chances of European unity and a single currency are going down the drain.

* *

Why are European central banks reluctant to follow the Fed's example of driving rates down to below the inflation rate (negative rates)? The answer: many (including Richard Russell) believe that the Fed has trapped itself. It cannot now allow rates to rise very much, since a rate rise will collapse the bond market. Moreover, every 1% rise in rates increases the federal budget by over $40 billion annually. Thus if the bond market sinks or if the Fed purposely raises the rates there are huge political ramifications.

* *

One problem with the Clinton medical program is that almost all new costs will be piled on small business. Since this is where most of any new employment will be created, adding cost to small business will be a huge negative for today's sputtering jobless "recovery." The September 27 *WSJ* in its editorial writes, "It ought to tell you something that the Clinton plan has actually won over a measure of popularity in the precincts of the Fortune 500 . . . Jollied along by the unions and tax distortions, these companies doled out inflated health benefits for two decades. Now these folks smell an opening to dumping those costs off on taxpayers as well as emerging small competitors." Russell comment: Cute, huh?

* *

This may not be what the future has in store for the US economy, but *Industry Forecast*, Box 27, Chappaqua, NY 10514, has an awfully good record: *"Trouble will begin with the new year. Higher taxes, the federal government's salary freeze, defense cuts, and other measures will add up to a $40 billion or larger reduction in the fiscal stimulus at a time when profit margins will already be slim. Virtually all measure of profits will decline in the first half of 1994. There is a serious danger of a recession beginning during the initial six months of next year. We continue to estimate the probability of a downturn to be 60%."*

Most people (and economists) don't realize that our economy is now "living" on federal deficits of $1 billion a day. What happens if we cut back on those deficits? The cut-backs become deflationary. The Levy's, who write *Industry Forecast*, recognize this. So if they're correct, if the deficits (or let's call it fiscal

stimuli) are cut back by around $40 billion, what happens? Well, we'll find out, won't we?

* *

The US trade balance continues to move way to the negative side. The problem: Americans love their imports. In 1992 imports surged 9% over '91, and in this year's first half imports grew at an 11% pace over '92. Furthermore, imports are growing from Japan, Mexico, Canada and Europe. China has become a huge importer to the US. In 1990 the US spent $15.1 billion on Chinese imports. In 1992 Chinese imports rose to $25.5 billion, and the US deficit to China alone climbed to $18.1 billion. What this means is a loss of jobs in the US as manufacturers overseas supply an increasing amount of goods to US consumers. At some point, if the US trade balance continues to deteriorate, tremendous pressure will be exerted against the dollar.

* *

The devaluations go on. Last week Hungary devalued its forint by 4.5% against a basket of US dollars and D-marks. In the meantime the Russian ruble sank to a new low of 1,300 to the dollar.

Devaluation call hits peso value

By Jose Galang in Manila

THE PHILIPPINE peso has dropped sharply on foreign

posed impos cent surcharg likely to ben devaluation:

Australian $ under pressure

By Nikki Tait in Sydney

THE Australian dollar came under renewed pressure yesterday, after news that a deterior-

deficit of A$1.15bn, and the market had expected the unadjusted figure to stand in the A$1bn-A$1.3bn range.

However, in Canberra, Mr

* *

Alicia Munnell, one of Hillary's friends and number two at the Treasury, wants to impose a one-time 15% tax on the market value of every private pension, profit-sharing plan, Keogh and IRA in the US. Last year Munnell published her views in the *New England Economic Review* in a piece entitled, "Taxation of Pension Plans: The Time Has Come."

* *

Ever watch the QVC channel? Occasionally, I do, and I'll admit that I find it a bore. But if you like shopping by TV, cheer up. Time Warner together with Spiegel are planning on two more cable TV shopping channels. Sorry, Mr. Diller, you may have thought you had a monopoly with QVC. Not quite. In the meantime, QVC is planning Q2, an upscale shopping channel. Get ready for the TV shopping channel parade.

* *

If you're a banker and plan on embezzling, I suggest you don't do it in China. The penalty there is severe. Last week eight embezzlers (including one woman) were pronounced guilty by Chinese authorities. Said the vice president of the court, "These people lusted for profits, were very bold and ran wild. They took advantage of the poor management of their banks." Chinese "justice" is swift. All eight were immediately taken out and given the Chinese version of capital punishment, a bullet in the back of the head.

* *

I see Warren Buffet, America's richest person, and CEO of Berkshire Hathaway, is trading $400 million of his Berkshire stock to buy Dexter Shoe Co. Billionaire Buffet is no dummy, so what's he thinking of? Well, first of all, he knows the shoe business, and he obviously thinks Dexter is a buy. But second, Buffet must think a going shoe company has a better future than a pile of dollars. If he didn't, he'd be selling his other shoe company (he already owns one -- Brown Shoe Co.) and be collecting dollars instead.

* *

Big Bucks: Talk is that the new MGM Grand casino in Las Vegas will hire Barbra Streisand for Dec. 31 and Jan. 1, which would be two weeks after the opening of this, the world's biggest gambling casino. Rumored price for Barbra's two days of performance -- $20 million.

* *

Would you believe it? The first Ford Mustang convertible (the original Mustang) was introduced in 1964. The price $2,368.

* *

The Russians must have been reading these Letters. I've said all along that the Russians should have backed their now-collapsed ruble with gold. But I guess the Russkies were listening to Harvard economists or maybe the US Treasury. At any rate, the Russians may finally be getting smart. Instead of selling more of their gold, they're backing a new issue of 10,000 bonds with gold. Each bond will cost about $126,600 and will be backed with 352 ounces of gold. You know what -- those bonds will sell out -- fast.

Russia Plans to Use Gold As Backing for Bond Issue

A WALL STREET JOURNAL *News Roundup*

MOSCOW—The Russian government plans to use more than 100 tons of its gold reserves to back a major issue of one-year bonds, putting the nation's natural resources to use in boosting investor confidence.

Each of the 10,000 bonds would be backed by 352 ounces of gold, said Bella Zlatkis, head of the securities department at the Russian Ministry of Finance. The bonds would sell for the ruble equivalent of the cost of that gold, based on the London fixing price. At current prices, Ms. Zlatkis said, each bond costs about 148 million rubles ($126,600).

The proceeds of the bond issue would be used to cover Russia's yawning budget deficit, estimated by the government at 12 trillion

* *

Last week I was looking through my father's 1913 university year book (that was the year he graduated from Columbia). In the back of the book there were about 20 pages of ads. This one struck me. Here is the Bank of New York, showing $2 million in capital and another $3.8 million in surplus and undivided profits. Can you believe it, a major bank boasting about $6 million in assets? Coincidentally, 1913 was the year that great "engine of inflation," the Federal Reserve system, came into being. Since 1913 or 1920 or even 1960 or '70, any way you look at it, the value and purchasing power of the dollar has been destroyed.

1784 1913

The Bank of New York

NATIONAL BANKING ASSOCIATION

48 WALL STREET, NEW YORK

Organized March 15, 1784 Incorporated as a National Bank, July, 1865

CAPITAL, $2,000,000. SURPLUS AND UNDIVIDED PROFITS $3,841,966.63

GOLD: A few facts: (1) Worldwide, production of gold is increasing at the rate of 1.7% a year. On the other hand, I estimate that the production, worldwide, of paper (fiat) money is increasing at a minimum rate of 6% a year. (2) The world now produces 2,200 tons of gold a year. But demand for gold has now risen to 3,500 tons per year (much of this demand comes from booming sales of gold jewelry). (3) The total value of the world's production of gold is roughly $25 billion. Over the last three weeks the broad M-3 money supply in the US increased by $17 billion. At this rate, in just three weeks the increase in US money supply would equal the value of the world's annual production of gold. (4) The market value of all the major gold mines in the world is roughly $40 billion. That equals about one-half the market value of Coca Cola.

Conclusion: Compared with common stocks or compared with the creation of US paper money or compared with the current rate of US debt build-up, they're giving gold away here -- it's cheap.

Gold detractors love to warn their audience that "gold is just another commodity." But Jim Turk reminds us of one crucial and little-recognized fact: every commodity except gold is produced for consumption. Gold, alone of all commodities, is produced for accumulation. The largest use of gold is in jewelry, which many people (particularly in Asia) consider as another form of real wealth. Actually, in India and other nations of Asia, 22 karat (almost pure) gold jewelry is sold by weight. In other words, in buying gold jewelry which they can also wear, Asian jewelry buyers are really simply accumulating wealth in the form of gold.

Inflation has been running rampant in China, and China's new capitalists have been buying all the gold they can get their hands on. In an effort to stem the tide; the Chinese government has raised the price of gold to $700 an ounce. Even at this price, the Chinese continue to accumulate gold.

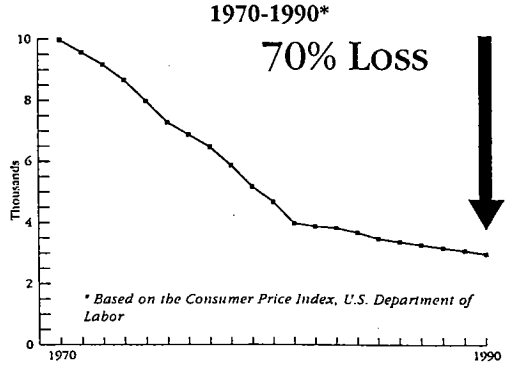
The battle for world exports is now in full swing. Every nation on the face of the globe wants to increase its exports. One way of doing this is by devaluing one's currency, making your products cheap and attractive to consumers from other nations. As Asian production of goods increases, as world competition becomes fiercer, my feeling is that an increasing number of nations will devalue their currencies. The one money that cannot be devalued by political edict is gold.

Of course, today you can buy gold with almost any paper currency. So the question is, why don't more people do it? My answer, they will, they will, it's simply a matter of time. But first people (and I'm talking about the masses) have to be worried about the purchasing power of their paper. That isn't happening, not just yet (except in China and India).

Aside from the favorable supply/demand factors for gold, we have the matter of the Clinton budget deficits. For instance, we know that over the next four years we will never see federal deficits drop below $200 million per year. Clinton will add at least $1.1 trillion to the national debt during his first term. In other words, there will be no reduction in the size of the national debt. Far from it, by the end of Clinton's first term the national debt will be at least $5.4 trillion and probably nearer $6 trillion. And that's based on today's low interest rates and an inflation rate supposedly holding below 4%.

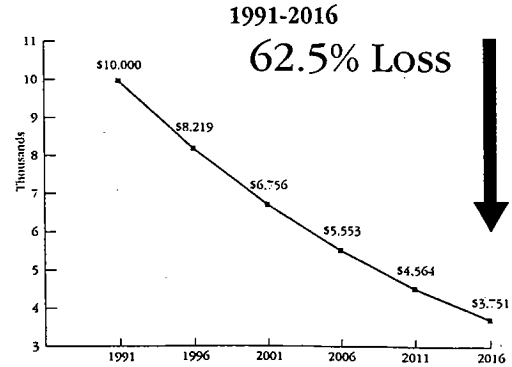
The accompanying charts provide a bit of history regarding the purchasing power of the dollar. The top chart shows you what has happpened to the purchasing power of the dollar during the 1970 to '90 period. The lower chart is a forecast for the dollar's future. Study these charts carefully, please.

DECLINE OF THE PURCHASING POWER OF THE U.S. DOLLAR 1970-1990*



Assume that you live on a $40,000 annual income today. If inflation grows at a very modest 4% per year, in 20 years you'll need an annual income of $87,645 to maintain the same standard of living. How will you ensure that your investment income keeps pace?

PROJECTED DECLINE OF PURCHASING POWER OF $10,000 1991-2016



All of the above constitute arguments for accumulating gold or gold stocks. Over an extended period of time it will require more and more dollars to buy one ounce of gold. Let me present it in a more personal way. In the mid-1970s I was buying one-ounce gold coins in the open market from our local coin dealer for around $70 a coin. At the same time I could buy a good dinner (soup to nuts) at a better restuarant for about 10 dollars. Today the same coin will cost me about $365. For that money I can now buy 10 dinners at a better restaurant. Those gold coins have held their purchasing power and then some.

Moral: Don't fret because your gold coins or gold stocks aren't going up this week or next. As sure as the dollar is heading down in purchasing power (if only at 3% or 4% a year), the value of your gold investments will be heading up. Furthermore, as the inefficient US government moves further and further into every area of American life, the deficits will continue to mount. No government agency has to make a profit. There's no critical bottom line for government. The real bottom line is that overspending is always handled via inflation. It's as simple and straightforward as that.

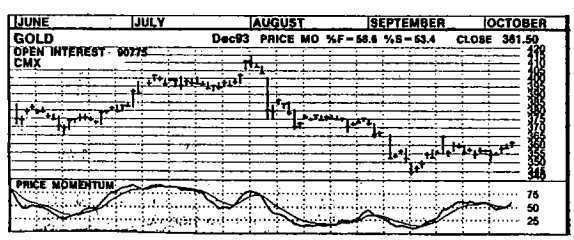
Ah, something new and much-needed. After much research, I've finally constructed a **Gold Primary Trend Index** (G-PTI). Unfortunately, I don't have enough back information on the G-PTI, and I am not able to obtain it. However, I am sure it will "work," since it is based on the same principle as my PTI. My latest figure for the G-PTI is 1074 (on Oct. 4 it was 1017). The new figures will be placed on page 1 of each issue of Dow Theory Letters.

Obviously, a steady rise in the G-PTI will indicate gold strength. Further strength will be indicated if preceding peaks are bettered. In due time, I will construct a chart of the G-PTI. For the next few weeks or months, however, we will have to be satisfied with whether the numbers on the G-PTI are increasing or decreasing. So far, the trend is UP.

LATE NOTES: Keep your eye on the **Utility Average** (page 1 chart). Its current declining trend is a potential negative for the market. Furthermore, the Utilities may be leading the way for bonds -- remember, utilities are extremely sensitive to the trend of interest rates, and they have often led the bonds (and the stock market) both up and down.

Nobody watches them any longer, but note -- M-2 and M-3 are starting to expand. And the rate-of-change in bank loans, which has been at record lows for the past three years, is now starting to surge . . . Straw in the wind: relative strength of *Investors Business Daily's* Consumer Stock Average has been rising since mid-June.

This chart *(courtesy Investors' Business Daily)* shows gold moving off its September lows, but the stochastics (momentum) at bottom of chart suggest that gold may be somewhat overbought. A consolidation or mild correction may therefore be in order.



For speculators only: the **T-bonds** could be making a triple top around the 120 area. I am wondering if this last surge in the bonds hasn't simply cleaned out all the stops. With the Utility Average heading down, how about a bet on lower bonds? It's an interesting spec, and I did it -- I bought the December 116 T-bond puts. Subscribers ask me about **gold calls.** I like the April 380s. Check your broker for the prices. I paid $8.50 per call.

NEXT MAILING: Oct. 27, 1993